

36 South Views

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Who is left to buy?

Everybody who has the ability to buy has jumped off the fence and piled into the equity market. Eerily reminiscent of 1987 and 2000. Shorts are also at their lowest level in decades and holders have been forced to buy back stock in the face of this relentless rally.

My kids, young friends and even a "travelling" workaway (they work in exchange for a bed and two meals) are doing online trading courses.

The social club as I call it i.e. doctors, dentists, airline pilots, taxi drivers and hairdressers are talking stocks.

The VIX is rising, not from fear, but greed. Call option buyers are overwhelming the market makers.

The narrowing of the leadership is more pronounced than any other bull market in history.

Unless this time is different, it won't be. A severe downturn is in the offing.

The bear stole my thunder a bit taking a big chunk out of the bull's behind in the last couple of days but as I write, no-one is remotely concerned.

The Fed is determined to keep rates low especially in the short-end for longer than is prudent even when, and if inflation emerges once again proving that it is not viable to have a dual mandate each of which is the opposite of each other. A mandate of full employment means low interest rates and a mandate of price stability means high interest rates (with inflation anyway).

If inflation prints at 4%, do you think holders of 10-30 year bondholders will be happy losing a real 3-4% a year? They won't and will exit en masse. The Fed will end up the buyer of last resort aka Japan. Like that famous tagline in "Jaws": "we are going to need a bigger boat!"

Humans are bad at calculating probability and risk. Casinos make money because we individually believe that we can beat the slot machine, even though we know that collectively we never have. We fear terrorism, but not driving to work in the morning, even though the latter is a much more significant threat to our well-being. On a biological level, our inability to impartially process probabilities on the fly is likely the fault of our amygdala, which shouts evolutionarily outdated advice from our temporal lobe. On a more basic level, our weakness is about our perception of the way risks mount (or don't) over time.¹

I love this passage and what rings true is our utter inability to see that the risks are accumulating over time.

The consequences of delaying any sort of reckoning become exponential not linear.

If you HAD to complete a two-foot jump every day, it would be easier and safer to do itevery day.

Delay it a week and you now have a 14-foot jump. It's going to hurt.

Delay it a month and you have 60 feet to jump. Probably fatal.

In the same way, if central banks keep suppressing the risks accumulating them, there is a point, and I think we are way past it, where it would be potentially fatal to face them.

¹ <https://www.inverse.com/article/12084-understanding-how-insurance-companies-calculate-risk-helps-you-game-the-system>

And so we will probably have to live with the unintended consequences of their policies.

Stratospheric asset prices.

Wealth inequality.

Growing dissent internally and externally within countries.

To name a few...

But nature always sides with the hidden flaw and prices will eventually reflect economic reality either by asset prices correcting or the denominator, the base currency deteriorating.

But what if all countries deteriorate at the same rate thus keeping the currencies relatively stable?

Then commodities, especially precious metals will be the instrument of truth and risk mitigation.

It is not going to be pleasant medicine whatever way it happens.

Can this risk unwind happen without volatility? Highly unlikely.

We have patiently waited through 9 years of low volatility and it eventually returned this year.

Will we return to stability?

I believe we have a stronger case for multi-year volatility events like 1997/1998 and 2000/2001.

The Black Swan that nobody is talking about is a multi-year period of extreme volatility.

Disclosure

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